REPORT OF EXAMINATION
OF THE

CLAREMONT LIABILITY INSURANCE
COMPANY

AS OF
DECEMBER 31, 2005

Participating State
and Zone:

California

Filed May 18, 2007

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San Francisco, California
April 5, 2007

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Company of Insurance
Richmond, Virginia

Honorable Kent Michie
Secretary, Zone IV-Western
Commissioner of Insurance
Department of Insurance, State of Utah
Salt Lake City, Utah

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

CLAREMONT LIABILITY INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 6250 Claremont Avenue, Oakland, California 94618.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005. The examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances. The examination was conducted concurrently with that of the Company's parent, Medical Insurance Exchange of California.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of Company; business in force by states; loss experience; and sales and advertising.

SUBSEQUENT EVENTS

In September 2006, the Company paid an ordinary dividend of $1.25 million to its parent company, Medical Insurance Exchange of California (MIEC).

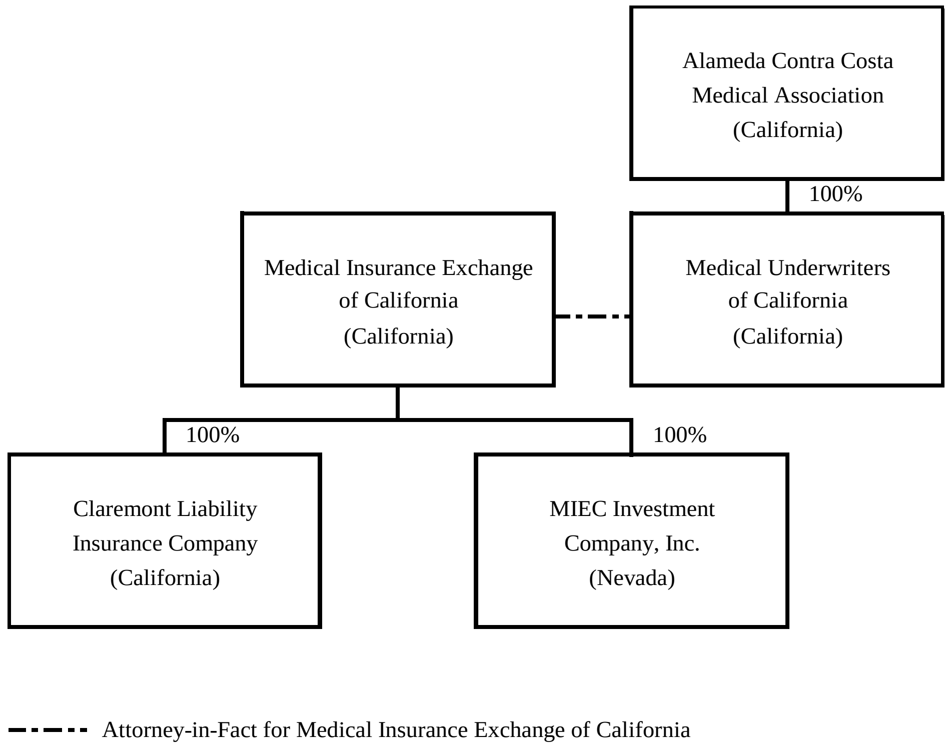
In February 2007, the Company's only policyholder, Children's Hospital of Oakland, California (Hospital), did not renew its policy with either the Company or MIEC. The Company expects to issue tail endorsements for the physicians covered under the hospital policy. The Hospital has indicated that it will not purchase tail coverage for the hospital. The Company management has indicated that it does not plan for any other direct writings in the near future and that MIEC is currently considering selling the Company.

An "A" rated, U.S. insurance entity which specializes in acquiring run-off business has expressed interest in acquiring the run-off of the contractor liability program from Lloyd's of London (Lloyd's), the reinsurer of the program which the Company fronted on behalf of Lloyd's from 2000 through 2002. The two entities are currently performing due diligence in anticipation of a possible proposal. The Company has indicated that it will not agree to release Lloyd's from its obligations under the program while the Company still retains responsibility for the program. As such, an acceptable deal may include the purchase of the Company.

The Company is in the process of re-filing Schedule "F", Part 6 and 7 of its 2006 Annual Statement. The re-filing is for the purposes of correcting errors that were noted and reclassifying certain overdue reinsurance recoverables totaling $697,000 as "in dispute." The Company reclassification of the overdue recoverables as "in dispute" is based on the Company and MIEC's (Companies) position that the dispute with respect to reinsurance recoverables from another claim (Redding) within the same reinsurance program can be ascribed to the recoverables in question. The Companies plan to work with the California Department of Insurance with respect to whether the Companies' position that the overdue recoverables are "in dispute" adheres to statutory accounting principles. Not reclassifying the recoverables as "in dispute," would necessitate the Company to increase its provision for reinsurance by $1.977 million, thereby reducing its surplus by the same amount. MIEC's surplus would also be reduced by $1.977 million through its ownership of the Company less a reduction of $474,915 in Schedule "F" penalties arising from its own related overdue recoverables. If booked, the amounts would not have a material impact on the Companies.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of the Medical Insurance Exchange of California (MIEC). All members of the board of directors are physicians, who also serve as members of MIEC's board of governors. Except for its officers, the Company has no employees. The Company's daily operations are managed by its contract manager, Medical Underwriters of California (MUC), in accordance with an administrative services agreement. MUC is wholly-owned by the Alameda Contra Costa Medical Association and is MIEC's attorney-in-fact. The Company is part of a holding company system, in which the ultimate controlling entity is MIEC. The following chart depicts the companies within the holding company system:



Management of the Company is vested in a fifteen-member board of directors. A listing of the board members and principal officers serving on December 31, 2005 follows:

Directors

Name and Residence	Principal Business Affiliation
Bradford P. Cohn, M.D., Chairman Napa, California	Physician
William G. Donald, Jr., M.D., Vice Chairman [1] Berkeley, California	Physician
Conrad E. Anderson, M.D., Secretary [2] Fremont, California	Physician
Clarence S. Avery, M.D. [3] Oakland, California	Physician

[1] Retired December 31, 2005. Replaced by Ann Louise Vercoutere, M.D.
[2] Retired December 31, 2005. Replaced by Scott Andrew Hoffinger, M.D.

Name and Residence	Principal Business Affiliation
James G. Campbell, M.D. [4] Redding, California	Physician
Thayer E. Cleaver, M.D. Mt. Shasta, California	Physician
Ronald V. Dorn III, M.D. Boise, Idaho	Physician
Fernando V. Dulay, M.D. Daly City, California	Physician
James O. Gemmer, M.D. Suisun, California	Physician
Charles L. Hoffman, M.D. [5] San Rafael, California	Physician
Harry Lee Jr., M.D. [6] San Francisco, California	Physician
Mark Oscherwitz, M.D. San Francisco, California	Physician
Lamont D. Paxton, M.D. San Leandro, California	Physician
Douglas G. Smith, M.D. Anchorage, Alaska	Physician
Russell T. Stodd, M.D. Kahului, Hawaii	Physician

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[3] Term expired December 31,2006. Replaced by Toni Brayer, M.D.
[4] Deceased May 2006. Not yet replaced.
[5] Term expired December 31, 2006. Replaced by Robert Margolin, M.D.
[6] Term expired December 31, 2006. Replaced by Cheryl Tanasovich, M.D.

Principal Officers

Name	Title
Ronald B. Neupauer	President
Lawrence R. Mello	Secretary and Treasurer

Inter-Company Agreements

Administrative Services Agreement: Pursuant to the agreement, the Company's contract manager, MUC, manages the daily operations of the Company on a cost-reimbursement basis. Services provided under the agreement include: solicitation of business, underwriting and policy issuance, premium collection, accounting, and claim adjustment services. The agreement was approved by the California Department of Insurance (CDI) on August 11, 2004. On the same date, the CDI determined that due to the affiliation between MUC and the Company, the service contract relationship between them is exempted from provisions of the Managing General Agents Act.

Tax Allocation Agreement: The Company is party to a tax allocation agreement with its parent, MIEC, and its affiliate, MIEC Investment Company, Inc. The agreement which became effective May 26, 1996 provides for the federal tax returns of the parties to be filed on a consolidated basis. Allocation is based on separate company return calculations with current credit given to a company for net losses or tax credits to the extent losses and/or credits result in an actual reduction to the consolidated group's tax liability.

TERRITORY AND PLAN OF OPERATION

The Company specializes in underwriting medical professional liability for hospitals, clinics, contracting groups and managed care organizations. In 2005, the Company only wrote medical professional liability coverage with limits up to $5 million for a single California hospital. Excess policies were also written with limits up to $15 million on the same risk. All policies have a February 1st effective date.

The Company is licensed to write in California, Hawaii, Idaho, Nevada, Oregon, and Washington. During the examination period, 100% of premiums written were in California. Direct premiums written were $1.7 million in 2005.

REINSURANCE

Assumed

The Company did not assume any business during the examination period.

Ceded

The Company's stop-loss agreement with its parent, Medical Insurance Exchange of California (The Exchange), was terminated effective January 1, 2005. The Exchange paid the Company $11.6 million for losses subject to this contract. The Company had the following ceded reinsurance contracts with either authorized insurers or Lloyd's syndicates in force at December 31, 2005:

Type of Contract	**Reinsurers**	**Company Retention**	**Reinsurer's Maximum Limits**
Excess Cession	Lloyd's Underwriters (30.0%) Hannover Ruckversicherungs – AG (25.0%) Transatlantic Reinsurance Company (20.0%) Platinum Underwriters Reinsurance, Inc. (15.0%) Berkley Insurance Company (10.0%)	$2 million each loss per policy/ $4 million in the aggregate per policy	$3 million excess of $2 million each loss per policy/ $3 million excess of $4 million in the aggregate per policy
"Clash"Excess of Loss	Lloyd's Underwriters (60.0%) Transatlantic Reinsurance Company (15.0%) Platinum Underwriters Reinsurance, Inc. (15.0%) Berkley Insurance Company (10.0%)	$4 million each loss occurrence where two or more insureds are involved in the same loss occurrence	$4 million excess of $4 million each loss occurrence where two or more insureds are involved in the same loss occurrence

Type of Contract	Reinsurers	Company Retention	Reinsurer's Maximum Limits
Catastrophe Excess of Loss	Lloyd's Underwriters (92.86%) Aspen Insurance UK Limited (7.14%)	Section (A): either $2 million or $4 million depending on inuring reinsurance Section (B): $250,000	Section (A): $10 million excess of either $2 million or $4 million depending on inuring reinsurance Section (B): $5 million excess of $250,000

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of the review, recommendations were made to strengthen controls in the following areas: disaster recovery/business continuity planning, application development and program change controls, privacy and confidentiality of private and financial information, system development life cycles standards, and documentation standards. The examination findings were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information system controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders from December 31, 2002 through December 31, 2005

Statement of Financial Condition
as of December 31, 2005

Assets	Ledger and Nonledger Assets	Nonadmitted Assets	Net Admitted Assets	Notes
Bonds	$25,358,292	$	$25,358,292	(1)
Cash, cash equivalents and short-term investments	1,473,678		1,473,678	
Investment income due and accrued	263,807		263,807	
Uncollected premiums and agents' balances in the course of collection	178,763		178,763	
Amounts recoverable from reinsurers	932,208		932,208	
Net deferred tax asset	1,417,044	1,100,529	316,515	
Total assets	$29,623,792	$ 1,100,529	$28,523,263	

Liabilities, Surplus and Other Funds

Losses		$12,372,890	(2)
Loss adjustment expenses		1,269,202	(2)
Other expenses (excluding taxes, licenses and fees)		3,572	
Taxes, licenses and fees (excluding federal and foreign income taxes)		11,584	
Unearned premiums		77,296	
Ceded reinsurance premiums payable		235,805	
Amounts withheld or retained by company for account of others		263,526	
Provision for reinsurance		205,000	
Payable to parent, subsidiaries and affiliates		1,333,654	
Total liabilities		15,772,529	
Common capital stock	$3,000,000		
Gross paid-in and contributed surplus	7,050,000		
Unassigned funds (surplus)	2,700,734		
Surplus as regards policyholders		12,750,734	
Total liabilities, surplus and other funds		$28,523,263	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income		
Premiums earned		$ (296,644)
Deductions:		
Losses incurred	$1,637,860	
Loss expenses incurred	772,688	
Other underwriting expenses incurred	30,094	
Total underwriting deductions		2,640,642
Net underwriting loss		(2,937,286)
Investment Income		
Net investment income earned	$ 893,161	
Net realized capital gain	79,875	
Net investment gain		973,036
Net loss before dividends to policyholders and before federal income taxes		(1,964,250)
Federal income taxes incurred		277,384
Net loss		$(2,241,634)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004		$14,769,363
Net loss	(2,241,634)	
Change in net unrealized capital losses	(29,756)	
Change in net deferred income tax	932,460	
Change in nonadmitted assets	(673,700)	
Change in provision for reinsurance	(75,000)	
Aggregate write-ins for gains in surplus	69,000	
Change in surplus as regards policyholders for the year		(2,018,630)
Surplus as regards policyholders, December 31, 2005		$ 12,750,734

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2005

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2002, per Examination			$12,804,534
Net income	$ 137,241	$	
Change in net unrealized capital gains	15,329		
Change in net deferred income tax	490,938		
Change in nonadmitted assets		492,308	
Change in provision for reinsurance		205,000	
Total gains and losses	$ 643,508	$ 697,308	
Net decrease in surplus as regards policyholders			(53,800)
Surplus as regards policyholders, December 31, 2005, per Examination			$12,750,734

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

Because Wells Fargo Bank, N.A., the Company's custodian, moved its headquarters from California to South Dakota, it is no longer considered a "qualified custodian" as defined by California Insurance Code (CIC) Section 1104.9. It is recommended the Company deposit its securities with a qualified custodian, subcustodian, or depository located in California per CIC Section 1104.9 and enter into an approved custodial agreement.

(2) Losses and Loss Adjustment Expenses

The Company's reserves for losses and loss adjustment expenses were reviewed by a California Department of Insurance Casualty Actuary and were determined to be reasonable.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information Systems Controls (Page 8): It is recommended that the Company review the recommendations made regarding its information systems and make appropriate changes to strengthen internal controls.

Bonds (Page 13): It is recommended the Company deposit its securities with a qualified custodian, subcustodian, or depository located in California per California Insurance Code Section 1104.9 and enter into an approved custodial agreement.

Previous Report of Examination

Management and Control – Inter-Company Agreements (Page 5): It was recommended that the Company resolve all issues with the California Department of Insurance (CDI) related to the administrative services agreement with its contract manager, Medical Underwriters of California (MUC). The agreement was approved for Company use by the CDI on August 11, 2004. On the same date, the CDI determined that due to the affiliation between MUC and the Company, the service contract relationship between them is exempted from provisions of the Managing General Agents Act. All issues have therefore been resolved.

Territory and Plan of Operation (Page 6): It was recommended that the Company contact the CDI to resolve a California Insurance Code Section (CIC) 1011(c) violation involving the 100% cession of a contractors' liability program during the years 2000 through 2002. The Company has complied and the matter has been resolved.

Reinsurance – Ceded (Page 8): It was recommended that the Company amend the insolvency provisions of its reinsurance agreements to conform to CIC requirements. All reinsurance agreements now have acceptable insolvency clauses.

Accounts and Records (Page 10): It was recommended that the Company make changes to its claims system and procedures to ensure that claims data is accurate. The Company has made changes which have corrected earlier problems.

Accounts and Records (Page 10): It was recommended that the Company report inter-company receivables and payables separately in its Annual Statement. The Company has complied.

Account and Records – Information Systems Controls (Page 10): It was recommended that the Company evaluate the recommendations from the information system control review and make appropriate changes to strengthen its information system controls. Review of those controls for this examination indicated the Company had made appropriate changes, with the exception of application development/program change controls and privacy policy and procedures.

Comments on Financial Statement Items - Bonds and Stocks (Page 15): It was recommended that the Company sign a new custodial agreement with its custodian that incorporates the same wording as the approved agreement that its parent, Medical Insurance Exchange of California (MIEC), has. A new agreement has been signed which is identical to the MIEC agreement.

Comments on Financial Statement Items - Losses and Loss Adjustment Expenses (Page 15): It was recommended that the Company develop a more comprehensive Claim Procedures Manual. A new Claims Procedures Manual has been adopted.

ACKNOWLEDGEMENT

Acknowledgement is made of the courtesy and cooperation extended by the Company's officers and the employees of Medical Underwriters of California during the course of this examination.

Respectfully submitted,

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Isabel Spiker, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California